IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 127 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE M.S.SHAH
and
Hon'ble MR.JUSTICE D.A.MEHTA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

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KALINDI INVESTMENT P LTD

Versus

COMMISSIONER OF INCOME TAX

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Appearance:

1. INCOME TAX REFERENCE No. 127 of 1988
MR RK PATEL for Petitioner No. 1
MR BB NAIK for MR MANISH R BHATT for Respondent No. 1

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CORAM : MR.JUSTICE M.S.SHAH
and
MR.JUSTICE D.A.MEHTA

Date of decision: 10/10/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE M.S.SHAH)

In this reference at the instance of the assessee, following questions have been referred by the Tribunal for our opinion in respect of assessment year 1975-76:-

(i) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in confirming the disallowance of short term capital loss amounting to Rs.1,24,545/- arising out of loss incurred on account of sale of shares in question to M/s.Ambernath Investments Pvt. Ltd. which was a wholly owned subsidiary company of M/s. Kaveri Investments Pvt. Ltd., which, in its turn was a wholly owned subsidiary company of the assessee company ?

(ii) Whether the Tribunal was justified in interpreting various relevant provisions of various Acts such as Section 45, 47 (iv)(a), 2 (17), 2 (26) of the I.T. Act as well as section 4 etc. of the Companies Act, 1956, while arriving at the conclusion that the loss in question was incurred on account of transaction between the parent company and the subsidiary company and hence the same was disallowable u/s.47 (iv)(a) of the Act in spite of the fact that the assessee company did not hold all the share capital of M/s. Ambernath Investments Pvt.Ltd. ?

2. The facts leading to this reference are as under:-

2.1 The assessee is a private limited company (the Company) earning dividend and interest income from its activities of making or holding investments and financing industrial enterprises. It maintains its books of account on mercantile system of accounting. For the assessment year under consideration i.e. 1975-76, for which the accounting period ended on 31st March, 1975, the assessee company filed its return of income declaring total loss of Rs.3,02,858/-. The total loss included an amount of Rs.1,26,201/- claimed by the assessee to have been incurred on account of short term capital loss. At the assessment proceedings, the I.T.O. noted that during the accounting period the assessee had sold its 2300 shares of M/s. Sarabhai Management Corporation Ltd. a private limited company, on 20th January, 1975 to its subsidiary company viz. M/s. Ambernath Investments Pvt. Ltd. company for Rs.13,600/- only at the rate of

Rs.6/per share. The said shares had been purchased by the assessee company on 30th July, 1973 for Rs.1,38,345/at the rate of Rs.60-15 per share. The difference of Rs.1,24,545/- was claimed by the company as short-term capital loss occasioned as a result of transfer of the said shares by it to M/s. Ambernath Investments Pvt. Ltd. Co.. The I.T.O. rejected the assessee's claim on the ground that the transferee company i.e. M/s. Ambernath Investments Pvt. Ltd.Co. was a subsidiary company of the assessee company and, therefore, the case was clearly covered by the provisions of sec. 47 (iv) of the Act.

2.2 The company took the matter to the CIT (A) in appeal. The CIT (Appeals) confirmed the order of the I.T.O. on two grounds. In the first place, the CIT confirmed the finding of the I.T.O. that M/s. Ambernath Investments Pvt. Ltd. Co. was a wholly owned subsidiary company of the assessee company by virtue of the fact that M/s. Ambernath Investments Pvt. Ltd. Co. was a wholly owned subsidiary of M/s.Kaveri Investments Pvt. Ltd. which in turn was a wholly owned subsidiary company of the assessee company. Hence, the provisions of section 47(iv) were applicable and, therefore, the transaction in question was not a transfer falling within the meaning of section 45 of the Act read with section 47 of the Act. The C.I.T. further held that the shares transferred were in a private limited company and had been transferred at a depreciated value which was much lower than the market value because the transaction was between the holding company and a second stage subsidiary company and, therefore, there was no genuine loss incurred by the assessee in this transaction.

2.3 The assessee carried the matter in appeal to the Tribunal. The Tribunal confirmed the finding of both the lower authorities that the provisions of section 47 (iv) were attracted because M/s. Ambernath Investments Pvt. Ltd. Co. was a wholly owned subsidiary of M/s. Kaveri Investments Pvt. Ltd. which was a wholly owned subsidiary of the assessee company. For this purpose, the Tribunal relied on the definition of `holding company' and `subsidiary company' as given in section 4 of the Companies Act, 1956. Since the Tribunal upheld the order under appeal on the first ground, the Tribunal did not express any opinion on the second ground which had appealed to the C.I.T. (Appeals). In this reference both the questions have been referred at the instance of the assessee only.

3. We have heard Mr. R.K. Patel learned counsel

for the assessee and Mr. B.B. Naik learned counsel for the revenue.

4. Although two separate questions are referred, the basic controversy between the parties is a narrow one. The transaction of sale of shares by the assessee company to M/s. Ambernath Investments Pvt. Ltd. Co. is held out by the assessee company as a transfer which resulted into capital loss. According to the revenue, Section 45 provides for tax on capital gains arising on transfer of asset but in the facts of this case, there was no transfer of asset in the first place because the transaction in question was covered by the provisions of section 47(iv) of the IT Act read with section 4 (1) of the Companies Act, 1956.

4A. The relevant provisions of the Income Tax Act reads as under :-

Sec.45. Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections. ....., be chargeable to income-tax under head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.

Sec.47. Nothing contained in section 45 shall apply to the following transfers:-

(i) .....
(ii) .....
(iii) .....

(iv) any transfer of a capital asset by a company to its subsidiary company if-

(a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and

(b) the subsidiary company is an Indian company;

(v) any transfer of a capital asset by a subsidiary company to the holding company, if-

(a) the whole of the share capital of the subsidiary capital is held by the holding company, and

(b) the holding company is an Indian

company;

Section 2 defines "Company" and "Indian Company" as under:-

Sec. 2(17) "Company" means-

(i) any Indian company, or

.....

Sec. 2(26) "Indian Company" means a company formed and registered under the Companies Act, 1956 (1 of 1956) and includes .....

Provided that the registered office of the company ... is in India."

Section 4(1) of the Companies Act:

4(1). For the purposes of this Act, a company shall be deemed to be a subsidiary company of another if, but only if,-

(a) that the other controls the composition of its Board of Directors; or

(b) that the other -

(i) .....

(ii) holds more than half in nominal value of its equity share capital; or

(c) the first-mentioned company is a subsidiary of any company which is that other's subsidiary.

Illustration below subsection (1) of section 4, reads as under:-

Company B is a subsidiary of Company A, and Company C is a subsidiary of Company B. Company C is a subsidiary of Company A, by virtue of

clause (c) above. If Company D is a subsidiary of Company C, Company D will be a subsidiary of Company B and consequently also of Company A, by virtue of clause (c) above, and so on.

For the purposes of this reference, we are not concerned with the other provisions of section 4 of the Companies Act.

5. Mr. R.K. Patel for the assessee has raised the following contentions:-

5.1 Section 47(iv) contemplates transfer of a capital asset by a holding company to its subsidiary company and that since M/s. Ambernath Investments Pvt. Ltd. Co. was not a subsidiary company of assessee company, there was no question of applying section 47(iv). The assessee company did not hold whole of the share capital of M/s. Ambernath Investments Pvt. Ltd. Co. and, therefore, clause (a) of section 47(iv) was also not attracted. Of course, there is no dispute about the fact that M/s. Ambernath Investments Pvt. Ltd.Co. is an Indian company.

5.2 The Tribunal erred in invoking the provisions of the Companies Act, 1956 for applying section 47 (iv) to the facts of the instant case. Mr. Patel vehemently submitted that section 4 (1) of the Companies Act commences with the words "For the purposes of this Act" and that, therefore, the definition of `holding company' contained in the aforesaid provision cannot be applied for the purposes of section 47(iv) of the Income Tax Act which is a different enactment altogether.

5.3 Because the transaction in question resulted into capital loss, the revenue had held that it was not a transfer but if the transaction had resulted into capital gain, the revenue would have canvassed the other way round to rope in the income as taxable by treating it as a transfer of capital asset outside the purview of Section 47 (iv) and for that purpose the revenue would have contended that M/s. Ambernath Investments Pvt. Ltd. Co. was not the immediate subsidiary of the assessee company.

6. On the other hand, Mr. B.B.Naik learned counsel for the revenue has submitted that when the Income Tax Act itself does not contain any definition of `holding company' and `subsidiary company', and the Companies Act, 1956 is a special enactment for companies, there was

nothing wrong on the part of the Tribunal in relying on the definition of `holding company' contained in section 4 of the Companies Act, more particularly, when the assessee holds the entire share capital of M/s. Kaveri Investments Pvt. Ltd. and M/s.Kaveri Investments Pvt. Ltd. in turn holds the entire share capital of M/s. Ambernath Investments Pvt. Ltd. Co.. The provisions of section 4(1)(c) read with illustration thereof are clearly applicable in the facts of the instant case.

Mr. Naik further submitted that in any view of the matter, the C.I.T. (Appeals) had also given another ground for holding that there was no capital loss and, therefore also, the finding given by the Tribunal is not required to be disturbed.

7. Having heard the learned counsel for the parties, it appears to us that although Mr. Naik's first submission appears to be prima-facie attractive, there is no justification for transplanting the definition of `holding company' under the Companies Act into the provisions of section 47 of the Income Tax Act automatically. The Companies Act has been enacted to consolidate and amend the law relating to companies and certain other associations. Various regulatory provisions contained in the Companies Act are meant to make the companies accountable for their activities to the authorities as well as to the share holders and creditors. In order to ensure that a company having controlling interest in another company does not escape the liabilities of the other company, Section 4(1) of the Companies Act gives an expanded definition of a holding company.

8. On the other hand, the Income Tax Act, 1961 is a taxing statute. Income under various heads is subjected to levy of tax. Capital gains is one such head. Section 45 of the Income Tax Act provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall ..... be chargeable to income tax under head "Capital gains" and shall be deemed to be the income of the previous year in which the transfer took place. Since there could be border line transactions, the Legislature has taken care to provide in section 47 that certain transfers shall not be considered as transfers for the purpose of levy of capital gains. For instance, any distribution of capital assets on the total or partial partition of a Hindu undivided family is not to be treated as a transfer for the purpose of capital gains. So also, any distribution of capital assets on the dissolution of a firm, or

association of persons is not to be treated as a transfer for the purpose of capital gains. Similarly, any transfer, in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company is also not be treated as a transfer for the purpose of capital gains, subject to compliance with certain conditions.

The same section provides that, transfer of a capital asset by a holding company to its Indian subsidiary company or by a subsidiary company to its Indian holding company is not to be treated as a transfer for the purposes of capital gains. The words "any transfer of a capital asset by a company to its subsidiary company" would as per the ordinary grammatical construction contemplate only the immediate subsidiary company of the holding company as the holding company holds the share capital only of its immediate subsidiary company.

9. If the Legislature while enacting the Income Tax Act intended that the provisions of section 4 of the Companies Act should apply to a holding or a subsidiary company, under section 47 of the Income Tax Act, there was nothing to prevent the Legislature from making such an express provision. The question is when that is not done, whether the provisions of section 4(1)(c) are required to be read into section 47(iv) and (v) by necessary implication.

10. As we have already indicated earlier, section 4 of the Companies Act makes it clear that the expanded definition of `holding company' is applicable for the purposes of the Act. The object of the Companies Act being to make the companies more accountable to the authorities, shareholders and creditors, the Legislature gave an expanded definition of `holding company' for the purposes of the Companies Act. With emphasis on "control" of one company over another, the definition of `holding company' under the Companies Act clearly indicates control over the composition of the Board of Directors or holding more than half in nominal value of of its equity share capital of the other company are sufficient to treat the two companies in question as a holding company and a subsidiary company. On the other hand, the Legislature has provided different criteria for dealing with a holding company and a subsidiary company in the matter of taxing capital gains on transfer of assets between such companies. The Income Tax Act has carved out a smaller number of holding and subsidiary companies for the purposes of section 47 (iv) and (v).

The wider definition of a holding company with emphasis on "control" as the guiding factor is not adopted in clauses (iv) and (v) of section 47 of the Income Tax Act. It is specifically provided that the parent company or its nominees must hold the whole of the share of the capital company. The Legislature while enacting the Income Tax Act, therefore made a clear departure from the definition of holding company as contained in the Companies Act. In this view of the matter, there is no justification for invoking clause (c) of subsection (1) of section 4 of the Companies Act while interpreting the provisions of clauses (iv) and (v) of section 47 of the Income Tax Act, which lay down two specific conditions for applicability of the said clauses and which are quite different from the criteria laid down in subsection (1) of section 4 of the Companies Act, 1956 for giving a more expanded definition of a holding company to subject more companies to regulatory control under the Companies Act. On the other hand, the object underlying section 47 of the Income Tax Act, is to lay down exceptions to the legal provision (section 45) for taxing gains on transfer of capital assets. The general rule is to construe the exceptions strictly and not to give them a wider meaning.

11. In this view of the matter, we have no hesitation in expressing our view that the Tribunal was not justified in law in treating M/s. Ambernath Investments Pvt. Ltd. Co. as a subsidiary company of the assessee company for the purposes of clause (iv) of section 47 of the Income Tax Act, 1961.

12. Before giving our final answer to the questions referred to us, we may deal with the submission of Mr. Naik for the revenue that even if M/s. Ambernath Investments Pvt. Ltd. Co. is not to be treated as a subsidiary of the assessee company, the C.I.T. (Appeals) had given a second ground for upholding the order of the I.T.O. for disallowing the short-term capital loss arising on account of sale of shares by assessee company to M/s. Ambernath Investments Pvt. Ltd. Co..

In this reference it is not open to go into that question because the Tribunal did not consider the same and still the revenue did not seek any reference on that issue even after the assessee obtained the order for the present reference.

13. In view of the above discussion, our answer to both the questions referred to us is in the negative i.e. in favour of the assessee and against the revenue.

13. The Reference accordingly stands disposed of with no order as to costs.

(M.S. Shah,J)

(D.A. Mehta,J)

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